

ST 95-3

Tax Type: SALES TAX

Issue: Use Tax on Purchases, Fixed Assets, or Consumables

STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE HEARINGS DIVISION  
COUNTY OF SANGAMON

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DEPARTMENT OF REVENUE OF THE      )
STATE OF ILLINOIS                  )
                                   )   Docket #
      v.                            )   IBT #
                                   )
XXXXXX                             )
                                   )
      Taxpayer                     )
                                   )   Karl W. Betz
                                   )   Administrative Law Judge
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX, Chicago, Illinois for the Taxpayer.

SYNOPSIS: This case involves XXXXX, a corporation that did business in Illinois during the audit period by operating several pizza restaurants under the name XXXXX.

A hearing was convened, pursuant to Notice before the Illinois Department of Revenue, and the Taxpayer contested certain findings made by the Department Auditor after an audit of the company's books and records for the period January 1, 1987, through September 30, 1989. Upon completion of the audit, the auditor reviewed his findings with a representative of the Taxpayer who stated the company would not agree with the audit findings at that time. In accordance with the pertinent provisions of the Illinois Use and Retailers' Occupation Tax Acts, the auditor did cause to be issued a Correction of Returns. This corrected return was the basis of Notice of Tax Liability XXXXX issued November 29, 1990, for XXXXX, inclusive of tax, penalty, and interest.

At issue is the percentage of consumable purchases by Taxpayer that are entitled to the resale deduction. The Department established

additional use tax liability upon the basis that 9.1 percent of Taxpayer's sales are take-out, that is, consumed off the premises. The Taxpayer asserts additional exemption from use tax on the basis that its take-out sales during the audit period constituted 69.38 percent of its total.

XXXXX, Chief Financial Officer, testified on behalf of the Taxpayer and referenced Taxpayer Exhibits 1 through 4. XXXXX, also testified for the Taxpayer.

After reviewing the record, including all documentary evidence and testimony submitted by Taxpayer, I find the issue should be resolved partially in favor of the Taxpayer and partially in favor of the Department.

#### FINDINGS OF FACT:

1. The Department conducted a Retailers' Occupation and Use Tax Audit of the Taxpayer's business for the period January 1, 1987, through September 30, 1989. (Tr. 7-8).

2. During the audit period, Taxpayer was engaged in the restaurant business where it sold pizzas of varying sizes and related items such as salads and beverages. (Department Exhibit No. 2).

3. The audit was conducted in order to verify the amounts of taxable receipts and purchases reported by Taxpayer on its monthly sales tax returns. (Department Exhibit No. 2).

4. A 12 month test-check of the Taxpayer's purchase invoices was used by the auditor in extrapolating the amount of use tax liability upon consumable supplies and upon the paper and packaging materials.

5. The auditor, based upon the best available evidence, comprised of the Taxpayer's records showing a 9.1 take-out percentage for sales for its two Ohio restaurants, reached the determination that additional use tax was due by Taxpayer for the audit period. (Department Exhibit 2).

6. Based upon the documentary evidence presented at the hearing, the

take-out percentage (both delivery and carry-out) of Taxpayer's trade for the audit period is 39.86%. (Taxpayer Exhibits Nos. 1-4).

CONCLUSIONS OF LAW: Illinois Statutes impose a tax upon the privilege of using tangible personal property within Illinois. (35 ILCS 105/3). The Use Tax Act defines the term "Use" as the exercise of ownership power over tangible personal property, such as the pizza pans, boxes, paper cups and other items purchased by Taxpayer in this matter. (35 ILCS 105/2). However, the Use Tax Act exempts tangible personal property which is purchased for resale.

Title 86 Ill. Adm. Code Sec. 130.2070 (c)(4) states:

"Sales of paper napkins, drinking straws, paper cups and paper plates to restaurants (including drive-in restaurants) and other vendors of food or beverages for use on the premises as serving equipment in lieu of more durable kinds of serving equipment (such as linen napkins, metal drinking straws, glass or porcelain cups and plates) are taxable retail sales. Sales of paper napkins, drinking straws, paper cups and paper plates to food or beverage vendors are nontaxable sales for resale if the items are resold for a direct and specific charge, or if the items are employed as containers for food or beverages contained therein and are transferred with the food or beverages to the purchaser thereof either by being delivered by the food or beverage vendor away from his premises to his customers or by being delivered on the premises of the food or beverage vendor to customers who take the packaged food or beverages away from such premises with them for consumption elsewhere (i.e., the so-called "carry-out trade"). In general, it may be assumed that paper sacks, boxes, cartons and paper cups with lids, when sold to a food or beverage vendor, are for resale within the meaning of this paragraph. The same is true of paper cups which are used in serving beverages or other tangible personal property from a vending machine."

This regulatory section means that the paper napkins, pizza boxes, straws, cups and other items used by Taxpayer's customers on the restaurant premises are used in lieu of more durable goods and therefore are subject to Illinois Use Tax. This includes the paper or cardboard boxes in which single slices were served to customers. The portion of the same items that are carried out by the customers or accompanied pizzas delivered by Taxpayer personnel to customers off the premises, are not subject to Use Tax on the basis of the resale exemption. See *Sta-Ru Corporation v. Mahin*,

(1986), 64 Ill. 2d 330.

It is the position of Taxpayer that its percentage of take-out sales is 69.38%. (Taxpayer Exhibit No. 1, p. 15). To derive this percentage, Taxpayer supplied documentary evidence from its major supplier (Taxpayer Exhibit No. 3) that shows the number of pizza boxes sold by the supplier to Taxpayer, and this is divided according to the different box sizes. Taxpayer also submitted the number of each type of pizza sold from its computer data base (Taxpayer Exhibit 2) and computed a percentage of out-of-store sales from this data. However, the data used in the calculation for the small, heavyweight, medium and large pizzas was a 12 month period, but for the individual slices sold, only two months were used. To be statistically and mathematically valid, the slice units (SL) sold must be annualized in making this calculation. When this is done, the total annual portion of Taxpayer's sales that are take-out is calculated to be .398607916 as follows:

PIZZA TYPE	TOTAL UNITS SOLD	TAKE-OUT BOXES USED	TOTAL ANNUAL PERCENTAGE
SM	27,717	16,400	
HW	20,251	18,400	
MD	32,995	26,800	
LG	51,083	40,400	
SL	*1,496,592	*547,188	
	1,628,638	649,188	39.8607916
*ANNUALIZED			

By using their take-out percentage of 69.38, Taxpayer recalculated its Use Tax Liability to be \$13,770.00. (Taxpayer Exhibit No. 1, pp. 1-3). Taxpayer witnesses also testified that certain items purchased could only be used in its take-out trade and consequently should be totally excluded from tax. Taxpayer made these changes by excluding certain plastic forks, other utensils and soup bowls from the taxable exceptions established by the auditor on Schedule 7-B (Taxpayer Exhibit No. 1, p. 2). As noted above, I cannot agree with the use of the 69.38 percent because it

represents a skewed calculation. Using the weighted average take-out percentage of 39.86, the amount of Use Tax for which Taxpayer is liable is recalculated to be \$20,469.00. In making this computation, I have accepted the exclusion by Taxpayer of the bowls and other items on the basis they are exclusively for out-of-store use, but I cannot concur with the Taxpayer's exclusion of certain plastic cups from the Schedule 7-B exception projection category on the grounds they are promotional in nature. (Tr. 19; Taxpayer Exhibit No. 1, p. 2). While Taxpayer did prorate these items, its witnesses did not explain why they should be transferred out of the sample exceptions and taxed on an individual basis.

I find the utilization by an auditor of a sample test check audit for Use Tax liability to be in accord with generally accepted auditing methods, and because there is no evidence in this record to indicate any objection by Taxpayer to this test check procedure, I recommend the tax base for these cups be determined by the same extrapolation as performed by the auditor. This means taking the \$36,579.14 cost price, excluding the 39.86% take out portion, dividing by the number of sample months (12) and then multiplying by the audit period months (33) to get a base of \$60,496.41. This and the other category bases (FA \$9,091.00, other supplies \$115,555.00, Sch. 7-A \$113,581.00 and pans \$110,671.00) total to \$409,394.00 with the resultant \$20,469.00 tax liability.

In summary, I recommend the Final Assessment incorporate these recommended recalculations.

RECOMMENDATION: Based upon the above findings of fact and conclusions of law, I recommend the Department reduce Notice of Tax Liability XXXXX and issue a Final Assessment.

Karl W. Betz  
Administrative Law Judge